

FINANCIAL STATEMENTS

Town Of Clayton

Kent County, Delaware

December 31, 2010

TOWN OF CLAYTON
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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and Town Council
Town of Clayton
Clayton, Delaware

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Town of Clayton, Delaware, as of and for the year ended December 31, 2010, which collectively comprise the Town's basic financial statements as listed in the table of contents. The prior year summarized comparative information has been derived from the Town's 2009 financial statements, which were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Town of Clayton, is based on the report of the other auditors. These financial statements are the responsibility of the Town of Clayton's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

Management has not adopted a methodology for accounting and financial reporting by employers for post employment benefits other than pensions in the accompanying financial statements and, accordingly, has not considered the need to provide and disclose the annual expense and liability. Accounting principles generally accepted in the United States of America require that an adequate expense and liability be reported for other post employment benefits, which would decrease the assets and fund balances and change the revenues in the accompanying financial statements. The amount by which this departure would affect the assets, fund balances, and revenues of the accompanying financial statements is not reasonably determinable.

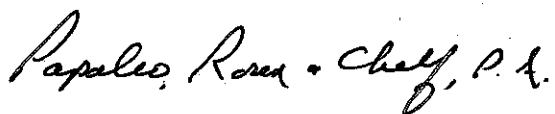
In our opinion, except for the effects of not providing an adequate liability and expense obligation for other post employment benefits for the accompanying financial statements as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the accompanying financial statements of the Town of Clayton, Delaware, as of March 2, 2011, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

To the Honorable Mayor and Town Council
Town of Clayton

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 2011, on our consideration of the Town of Clayton's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 9 and 32 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Town of Clayton's financial statements as a whole. The introductory section, combining nonmajor governmental fund financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. The combining nonmajor governmental fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.



Papaleo, Rosen & Chelf, PA
Wilmington, Delaware
March 2, 2011

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited
December 31, 2010

This discussion and analysis of the Town of Clayton, Delaware (the "Town") provides an overview of the Town's financial performance for the fiscal year ended December 31, 2010. Please read it in conjunction with the Town's financial statements which begin on page 10.

FINANCIAL HIGHLIGHTS

The assets of the Town exceeded its liabilities at December 31, 2010, by \$6.3 million (net assets). Of this amount, \$169 thousand (unrestricted net assets) may be used to meet the Town's ongoing obligations to its citizens and creditors. The Town's total net assets decreased by \$24 thousand. The current year decrease in the Town's net assets is due primarily to current year expenses, including transfers, exceeding revenues. Also, trash rates remained at \$19.20 per month.

As of December 31, 2010, the Town's governmental funds reported combined ending fund balances of \$2.7 million, a decrease of \$200 thousand as compared to the prior year. The current year decrease in fund balance can be attributed to transfers from other funds in order to cover expenditures throughout the course of the year.

As of December 31, 2010, the Town's proprietary funds reported combined net assets of \$2.6 million, an increase of \$123 thousand as compared to the prior year. The current year increase in net assets can be attributed to an increase in electric service charges and offset by a decrease in transfers to other funds. Electric billing rates remained the same for 2010. Sewer billing rates remained at \$16.50 for 3,000 gallons per month. In addition, approximately \$775 thousand was transferred from the proprietary funds to subsidize the government's primary operations.

Overview of the Financial Statements

The financial statements consist of three parts – management's discussion and analysis, the basic financial statements and required supplementary information. This discussion and analysis is intended to serve as an introduction to the Town of Clayton's basic financial statements. The Town of Clayton's basic financial statements are comprised of three components: 1) entity-wide financial statements; 2) fund financial statements; and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

The basic financial statements include two kinds of statements that present different views of the Town:

- The first two statements are entity-wide financial statements that provide both long-term and short-term information about the Town's overall financial status.
- The remaining statements are fund financial statements that focus on individual parts of the Town government, reporting the Town's operations in more detail than the entity-wide statements.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements.

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited (cont'd)
December 31, 2010

Entity-Wide Financial Statements. The entity-wide financial statements are designed to provide readers with a broad overview of the Town's finances, in a manner similar to a private-sector business. These statements are prepared using the accrual basis of accounting.

The statement of net assets presents information on all of the Town's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Town is improving or deteriorating.

The statement of activities presents information showing how the Town's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows only in future fiscal periods.

Both of the entity-wide financial statements distinguish functions of the Town that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the Town include general government, public safety, public works, and licensing and inspection. Business-type activities consist of the Town's electric distribution system and water supply and sewage collection system.

Fund Financial Statements. Traditional readers of government financial statements will find the fund financial statement presentation more familiar where the focus is on the Town's most significant funds. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Town uses fund accounting to ensure and demonstrate fiscal accountability. The Town uses governmental and proprietary fund financial statements to provide more detailed information about the Town's most significant funds rather than the Town as a whole.

Governmental Funds. Most of the Town's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year end that are available for spending. These funds are reported using the modified accrual accounting method, which measures cash and all other financial assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the Town's general government operations and the basic services it provides. Governmental fund information helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Town's programs. The relationship (or differences) between governmental activities (reported in the Statements of Net Assets and Activities) and governmental funds is described in a reconciliation.

Proprietary funds. Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises in which costs are recovered primarily through user charges. Proprietary fund financial statements, like entity-wide financial statements, provide both long and short-term financial information. The fund financial statements provide more detail and additional information, such as cash flows, for the Town's proprietary funds. The proprietary funds are used to report the same functions presented as business-type activities in the entity-wide financial statements. The Town uses proprietary funds to account for its electric distribution system and water supply and sewage collection system. The Town purchases 100 percent of its electric supply requirements from the Delaware Municipal Electric Corporation ("DEMEC") under a long-term full requirements service contract. In addition, the Town is charged a fee by the Town of Smyrna and Kent County to discharge the Town's proportionate share of wastewater into their respective facilities under an operating contract.

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited (cont'd)
December 31, 2010

Notes to the Basic Financial Statements. The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the entity-wide and fund financial statements.

Required Supplementary Information. In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning the Town. A budgetary comparison schedule has been provided for the General Fund.

FINANCIAL ANALYSIS OF THE TOWN AS A WHOLE

Entity-wide Financial Analysis

The following table presents a summary of the Statement of Net Assets for the Town as of December 31, 2010, and 2009:

Table 1 – Condensed Statement of Net Assets

	Governmental Activities		Business-type Activities		Totals	
	2010	2009	2010	2009	2010	2009
ASSETS						
Current and other assets	\$ 3,451,958	\$ 3,001,165	\$ 637,802	\$ 566,279	\$ 4,089,760	\$ 3,567,444
Capital assets, net	1,004,788	900,201	3,108,791	3,130,655	4,113,579	4,030,856
TOTAL ASSETS	4,456,746	3,901,366	3,746,593	3,696,934	8,203,339	7,598,300
LIABILITIES						
Other liabilities	748,462	79,291	365,886	426,783	1,114,348	506,074
Long-term liabilities	48,927	15,256	771,585	784,143	820,512	799,399
TOTAL LIABILITIES	797,389	94,547	1,137,471	1,210,926	1,934,860	1,305,473
NET ASSETS						
Invested in capital assets, net of related debt	964,238	900,201	2,302,919	2,313,139	3,267,157	3,213,340
Restricted	2,832,724	2,176,969	-0-	-0-	2,832,724	2,176,969
Unrestricted	(137,605)	729,649	306,203	172,869	168,598	902,518
TOTAL NET ASSETS	\$ 3,659,357	\$ 3,806,819	\$ 2,609,122	\$ 2,486,008	\$ 6,268,479	\$ 6,292,827

Invested in capital assets net of related debt decreased as a result of depreciation expense exceeding capital additions for the year. The largest portion of the Town's net assets reflects its investment in capital assets, less any related debt used to acquire those assets that are still outstanding. Capital assets are used to provide services to residents and are not available for future spending. Although the investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. Restricted net assets increased due to the accumulation of resources restricted to public works projects and future growth initiatives.

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited (cont'd)
December 31, 2010

Table 2 – Changes in Net Assets

	Governmental Activities		Business-type Activities		Totals	
	2010	2009	2010	2009	2010	2009
REVENUES						
Program revenues:						
Charges for services	\$ 426,283	\$ 455,175	\$ 3,326,414	\$ 2,943,710	\$ 3,752,697	\$ 3,398,885
Operating grants/ contributions	131,849	62,827	-0-	-0-	131,849	62,827
General revenues:						
Taxes	381,561	452,454	-0-	-0-	381,561	452,454
Investment earnings	12,916	1,342	1,795	435	14,711	1,777
Franchise fees	16,183	15,097	-0-	-0-	16,183	15,097
Miscellaneous	19,534	1,795	-0-	-0-	19,534	1,795
Transfers/Contributions	543,925	775,490	-0-	-0-	543,925	775,490
TOTAL REVENUES	1,532,251	1,764,180	3,328,209	2,944,145	4,860,460	4,708,325
EXPENSES						
General government	430,495	485,551	-0-	-0-	430,495	485,551
Public safety	790,051	862,664	-0-	-0-	790,051	862,664
Public works	379,730	379,146	-0-	-0-	379,730	379,146
Licensing and inspection	87,134	60,086	-0-	-0-	87,134	60,086
Electric operations	-0-	-0-	1,986,018	1,766,588	1,986,018	1,766,588
Water/Sewer operations	-0-	-0-	675,152	638,434	675,152	638,434
Transfers	-0-	-0-	543,925	775,490	543,925	775,490
TOTAL EXPENSES	1,687,410	1,787,447	3,205,095	3,180,512	4,892,505	4,967,959
INCREASE (DECREASE) IN NET ASSETS	(155,159)	(23,267)	123,114	(236,367)	(32,045)	(259,634)
NET ASSETS, BEGINNING OF YEAR	3,806,819	3,830,086	2,486,008	2,722,375	6,292,827	6,552,461
PRIOR PERIOD ADJUSTMENT	7,697	-0-	-0-	-0-	7,697	-0-
NET ASSETS, END OF YEAR	\$ 3,659,357	\$ 3,806,819	\$ 2,609,122	\$ 2,486,008	\$ 6,268,479	\$ 6,292,827

Governmental Activities

The cost of all governmental activities in 2010 was \$1.7 million. The amount that taxpayers ultimately financed for these activities through Town taxes was \$382 thousand, or 23 percent. Other costs were paid by those who directly benefited from the programs (\$426 thousand, or 25 percent) or by government agencies and organizations that subsidized funding with intergovernmental aid and contributions (\$132 thousand, or eight percent).

Charges for services decreased due primarily to a decrease in building permit and impact fees in the amount of approximately \$29 thousand which can be attributed to the decrease in development within Town limits. Decreases in taxes relate primarily to a decrease in transfer taxes from the prior year in the amount of \$90 thousand net of an increase in property taxes of \$19 thousand. The decrease in transfer taxes is due to the decrease in development within Town limits; the increase in property taxes is due to additional assessments related to development in prior years.

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited (cont'd)
December 31, 2010

As indicated by the governmental program expenses, general government programs accounted for 26 percent of the Town's governmental activities and remained consistent with prior year amounts. Public safety expenses accounted for 47 percent of the Town's governmental activities, public works expenses accounted for 23 percent, and licensing and inspection expenses accounted for 3 percent, all consistent with prior year amounts.

Business-type Activities and Proprietary Funds

Charges for services represent the principal revenue source for the Town's business-type activities and proprietary funds and increased by \$383 thousand over the prior year. Increases in charges for services can be attributed to an increase in electric usage in the current year. The overall expenses of the business-type activities increased by approximately 11 percent. Expense increases are due to an increase in electric purchased and sewer charges.

FINANCIAL ANALYSIS OF THE TOWN'S FUNDS

The Town uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the Town's governmental funds is to provide information on near-term inflows, outflows and balances of spendable resources. Such information is valuable in assessing the Town's financing requirements. In particular, the unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of December 31, 2010, the Town's governmental funds reported combined ending fund balances of \$2.7 million, a decrease of \$(200) thousand as compared to the prior year. Approximately 105 percent, or \$2.8 million, constitutes fund balance reserved for special purposes, leaving \$(130) thousand available for spending at the Town's discretion.

The General Fund is the chief operating fund of the Town. As of December 31, 2010, the total fund deficit of the General Fund was approximately \$(96) thousand, of which \$(279) thousand is unreserved and undesignated, \$149 thousand has been designated by the Town to fund future costs for post-employment benefits, \$30 thousand has been reserved for future police pension costs, and \$4 thousand has been reserved for inventory costs. The fund balance decreased by \$837 thousand during the year ended December 31, 2010.

The other major fund of the Town is the Impact Fees Fund which is used to accumulate resources for future growth initiatives as mandated by law.

Significant changes in revenues and expenditures for the governmental funds are consistent with the prior analysis of the governmental activities revenues and expenses. Other financing sources consisted of transfers from the proprietary funds to subsidize the government's primary governmental operations.

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited (cont'd)
December 31, 2010

GENERAL FUND BUDGETARY HIGHLIGHTS

The schedule comparing the Town's budget and actual results can be found on page 32. There were no amendments to the original budget. A summary of significant variations between budget amounts and actual results are as follows:

- Transfer tax revenue was \$11 thousand less than budget due to the timing of the completion of development projects and the sale of the associated properties.
- Intergovernmental revenue was \$86 thousand more than budget due to anticipated governmental support programs no longer offering support.
- General government expenditures were \$83 thousand less than budget due to the expectation of significant increases related to health insurance and property insurance.
- Public safety expenses were over budget by \$69 thousand due to the need for additional employees resulting in an increase in salaries and benefits for the public safety department.
- Public works expenditures were \$366 thousand less than budget due to the expectation of a need for additional employees and increasing premiums related to health insurance and property insurance.
- Capital outlay expenditures were \$2 thousand under budget due to the timing of the completion of repaving projects.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Town's capital assets for its governmental and business-type activities as of December 31, 2010, amounted to \$4.1 million net of accumulated depreciation. Capital assets include land, building and improvements, improvements other than buildings, machinery and equipment, vehicles, and infrastructure. The total net increase in the Town's capital assets for the current fiscal year was approximately \$83 thousand. Current year additions of \$333 thousand exceeded depreciation expense of \$278 thousand. In addition, there were capital assets of \$28 thousand that had been written off.

More detailed information about the Town's capital assets is presented in the notes to the basic financial statements.

Debt Administration

During the year ended December 31, 2010, the Town paid approximately \$33 thousand to bring the total debt to approximately \$785 thousand through the Delaware Department of Natural Resources and Environmental Control to finance the Town's water treatment facilities.

More detailed information about the Town's long-term liabilities is presented in the notes to the basic financial statements.

TOWN OF CLAYTON
Management's Discussion and Analysis – Unaudited (cont'd)
December 31, 2010

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The primary economic factor affecting the budget for the Town of Clayton is the residential housing market. Industrial and commercial activities are minimal. Impact fees imposed upon new residential construction support infrastructure improvements. Permit fees and transfer taxes support the operations of Public Works and Administrative department operations, respectively.

Rates for taxes and fees for services will remain consistent in 2010 in relation to 2009.

REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, customers, investors, and creditors with a general overview of the Town's finances. If you have questions about this report or need any additional information, please contact the Town of Clayton, 414 Main Street, P. O. Box 1130, Clayton, Delaware 19938-1130.

TOWN OF CLAYTON
STATEMENT OF NET ASSETS
DECEMBER 31, 2010
(With Summarized Comparative Data for December 31, 2009)

	Governmental Activities	Business-type Activities	Totals	
			2010	2009 *
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 2,826,892	\$ 523,917	\$ 3,350,809	\$ 3,386,796
Taxes receivable	20,809	-0-	20,809	15,482
Accounts receivable	2,138	43,384	45,522	77,006
Other receivables	26,779	-0-	26,779	19,735
Inventory	3,904	60,652	64,556	51,531
Prepaid expenses	16,491	3,131	19,622	16,894
Due from other fund	554,945	6,718	561,663	-0-
Total Current Assets	3,451,958	637,802	4,089,760	3,567,444
Noncurrent Assets:				
Capital assets, net	1,004,788	3,108,791	4,113,579	4,030,856
TOTAL ASSETS	\$ 4,456,746	\$ 3,746,593	8,203,339	\$ 7,598,300
LIABILITIES AND NET ASSETS				
LIABILITIES:				
Current Liabilities:				
Accounts payable	\$ 552	\$ 175,173	\$ 175,725	\$ 243,358
Due to other fund	561,663	-0-	561,663	-0-
Impact fee escrows	105,763	-0-	105,763	39,674
Accrued salaries and benefits	37,646	11,499	49,145	19,133
Accrued interest	-0-	8,810	8,810	9,625
Loan payable	24,035	34,287	58,322	33,373
Accumulated compensated absences	18,803	15,579	34,382	46,738
Utility deposits	-0-	120,538	120,538	114,173
Total Current Liabilities	748,462	365,886	1,114,348	506,074
Noncurrent Liabilities:				
Loan payable	16,515	749,856	766,371	784,143
Accumulated compensated absences	32,412	21,729	54,141	15,256
Total Noncurrent Liabilities	48,927	771,585	820,512	799,399
TOTAL LIABILITIES	797,389	1,137,471	1,934,860	1,305,473
NET ASSETS				
Invested in capital assets, net				
of related debt	964,238	2,302,919	3,267,157	3,213,340
Unrestricted (deficit)	(137,605)	306,203	168,598	902,518
Restricted for police	31,381	-0-	31,381	16,115
Restricted for public works	113,781	-0-	113,781	108,412
Restricted for future growth initiatives	2,687,562	-0-	2,687,562	2,052,442
TOTAL NET ASSETS	3,659,357	2,609,122	6,268,479	6,292,827
TOTAL LIABILITIES AND NET ASSETS	\$ 4,456,746	\$ 3,746,593	\$ 8,203,339	\$ 7,598,300

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Summarized Comparative Data for the Year Ended December 31, 2009)

	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities
					2010	2009 *
GOVERNMENTAL ACTIVITIES						
General government	\$ 430,495	\$ 6,366	\$ 7,602	\$ -0-	\$ (416,527)	\$ (479,192)
Public safety	790,051	48,836	78,928	-0-	(662,287)	(734,398)
Public works	379,730	334,623	45,319	-0-	212	(14,972)
Licensing and inspection	87,134	36,458	-0-	-0-	(50,676)	(40,883)
TOTAL GOVERNMENTAL ACTIVITIES	1,687,410	426,283	131,849	-0-	(1,129,278)	(1,269,445)
BUSINESS-TYPE ACTIVITIES						
Electric	1,986,018	2,627,892	-0-	-0-	-0-	641,874
Water/Sewer	675,152	698,522	-0-	-0-	-0-	23,370
TOTAL BUSINESS-TYPE ACTIVITIES	2,661,170	3,326,414	-0-	-0-	665,244	538,688
TOTAL PRIMARY GOVERNMENT	\$ 4,348,580	\$ 3,752,697	\$ 131,849	\$ -0-	(1,129,278)	(730,757)
GENERAL REVENUE						
Real estate taxes					\$ 297,090	\$ 297,090
Real estate transfer taxes					84,471	84,471
Franchise fees					16,183	16,183
Interest income					12,916	14,711
Miscellaneous					19,534	19,534
TRANSFERS					(543,925)	-0-
TOTAL GENERAL REVENUES AND TRANSFERS					974,119	431,989
CHANGE IN NET ASSETS					(155,159)	(32,045)
NET ASSETS, BEGINNING OF YEAR					3,806,819	2,486,008
PRIOR PERIOD ADJUSTMENT					7,697	-0-
NET ASSETS, END OF YEAR					\$ 3,659,357	\$ 2,609,122
					\$ 6,268,479	\$ 6,292,827

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
BALANCE SHEET – GOVERNMENTAL FUNDS
DECEMBER 31, 2010
(With Summarized Comparative Data for December 31, 2009)

	General Fund	Impact Fees Fund	Nonmajor Governmental Funds	Totals	
				2010	2009 *
ASSETS					
Cash and cash equivalents	\$ 473,661	\$ 2,238,380	\$ 114,851	\$ 2,826,892	\$ 2,941,227
Taxes receivable	20,809	-0-	-0-	20,809	15,482
Accounts receivable	2,138	-0-	-0-	2,138	20,390
Other receivables	26,779	-0-	-0-	26,779	4,379
Inventory	3,904	-0-	-0-	3,904	6,171
Prepaid expenses	16,491	-0-	-0-	16,491	13,516
Due from other funds	-0-	554,945	-0-	554,945	161,383
TOTAL ASSETS	\$ 543,782	\$ 2,793,325	\$ 114,851	\$ 3,451,958	\$ 3,162,548
LIABILITIES AND FUND BALANCES					
LIABILITIES:					
Accounts payable	\$ 552	\$ -0-	\$ -0-	\$ 552	\$ 1,424
Impact fee escrows	-0-	105,763	-0-	105,763	39,674
Accrued salaries and benefits	37,646	-0-	-0-	37,646	15,307
Accumulated compensated absences	18,803	-0-	-0-	18,803	22,886
Deferred revenue	20,809	-0-	-0-	20,809	15,482
Due to other funds	561,663	-0-	-0-	561,663	161,383
TOTAL LIABILITIES	639,473	105,763	-0-	745,236	256,156
FUND BALANCES:					
Unreserved – undesignated	(278,583)	-0-	-0-	(278,583)	687,742
Unreserved – designated for:					
Post-employment benefits	148,677	-0-	-0-	148,677	41,681
Reserved for police	30,311	-0-	-0-	31,381	16,115
Reserved for public works	-0-	-0-	1,070	113,781	108,412
Reserved for future growth initiatives	-0-	2,687,562	-0-	2,687,562	2,052,442
Reserved for inventory	3,904	-0-	-0-	3,904	-0-
TOTAL FUND BALANCES	(95,691)	2,687,562	114,851	2,706,722	2,906,392
TOTAL LIABILITIES AND FUND BALANCES	\$ 543,782	\$ 2,793,325	\$ 114,851	\$ 3,451,958	\$ 3,162,548

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

**TOWN OF CLAYTON
RECONCILIATION OF BALANCE SHEET – GOVERNMENTAL FUNDS TO STATEMENT OF NET ASSETS
DECEMBER 31, 2010**

TOTAL GOVERNMENTAL FUND BALANCES	\$ 2,706,722
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Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	1,004,788
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Some of the Town's assets are not available soon enough to pay for current period expenditures and, therefore, are deferred in the funds.	20,809
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Long-term liabilities, including loans payable that are not due and payable in the current period and, therefore, are not reported in the funds.	(40,550)
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Expenses accrued for compensated absences reported in the statement of activities that do not require the use of current financial resources are not reported as expenditures in the governmental funds.	<u>(32,412)</u>
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NET ASSETS OF GOVERNMENTAL ACTIVITIES	<u>\$ 3,659,357</u>
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The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Summarized Comparative Data for the Year Ended December 31, 2009)

	General	Impact Fees Fund	Nonmajor Governmental Funds	Totals	2009 *
REVENUES					
Taxes:					
Property taxes	\$ 276,281	\$ -0-	\$ -0-	\$ 276,281	\$ 262,825
Transfer taxes	84,471	-0-	-0-	84,471	174,147
Special assessment/impact fees	-0-	91,000	-0-	91,000	131,129
Charges for services	280,081	-0-	-0-	280,081	252,248
Intergovernmental	96,040	-0-	35,809	131,849	62,827
Licenses and fees	6,366	-0-	-0-	6,366	6,359
Fines and forfeits	48,836	-0-	-0-	48,836	65,439
Franchise fees	16,183	-0-	-0-	16,183	15,097
Interest income	2,237	10,218	461	12,916	1,342
Miscellaneous	14,534	-0-	-0-	14,534	1,795
TOTAL REVENUES	825,029	101,218	36,270	962,517	973,208
EXPENDITURES					
Current:					
General government	404,461	-0-	-0-	404,461	439,951
Public safety	717,879	-0-	8,391	726,270	804,865
Public works	289,785	12,000	26,124	327,909	354,229
Licensing and inspection	88,872	-0-	-0-	88,872	58,700
Debt Service:					
Principal	10,102	-0-	-0-	10,102	-0-
Interest	1,709	-0-	-0-	1,709	-0-
Capital outlays	184,789	-0-	-0-	184,789	22,747
TOTAL EXPENDITURES	1,697,597	12,000	34,515	1,744,112	1,680,492
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(872,568)	89,218	1,755	(781,595)	-0-
OTHER FINANCING SOURCES					
Proceeds from sale of capital assets	5,000	-0-	-0-	5,000	16,294
Loan proceeds	25,303	-0-	-0-	25,303	-0-
Transfers in	135,194	433,231	-0-	568,425	775,490
Transfers out	-0-	(24,500)	-0-	(24,500)	-0-
TOTAL OTHER FINANCING SOURCES	165,497	408,731	-0-	574,228	791,784
NET CHANGES IN FUND BALANCES	(707,071)	497,949	1,755	(207,367)	84,500
FUND BALANCES, BEGINNING OF YEAR	740,854	2,052,442	113,096	2,906,392	2,821,892
PRIOR PERIOD ADJUSTMENT	(129,474)	137,171	-0-	7,697	-0-
FUND BALANCES, END OF YEAR	\$ (95,691)	\$ 2,687,562	\$ 114,851	\$ 2,706,722	\$ 2,906,392

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
STATEMENT OF NET ASSETS – PROPRIETARY FUNDS
DECEMBER 31, 2010
(With Summarized Comparative Data for December 31, 2009)

	Electric Fund	Water And Sewer Fund	Totals	
			2010	2009 *
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 512,889	\$ 11,028	\$ 523,917	\$ 445,569
Accounts receivable	32,802	10,582	43,384	56,616
Other receivables	-0-	-0-	-0-	15,356
Inventory	49,746	10,906	60,652	45,360
Prepaid expenses	1,044	2,087	3,131	3,378
Due from other funds	6,718	-0-	6,718	-0-
Total Current Assets	603,199	34,603	637,802	566,279
Noncurrent Assets:				
Capital assets, net	1,114,454	1,994,337	3,108,791	3,130,655
TOTAL ASSETS	\$ 1,717,653	\$ 2,028,940	\$ 3,746,593	\$ 3,696,934
LIABILITIES AND NET ASSETS				
Current Liabilities:				
Accounts payable	\$ 153,036	\$ 22,137	\$ 175,173	\$ 241,934
Accrued salaries and benefits	3,833	7,666	11,499	3,826
Accrued interest	-0-	8,810	8,810	9,625
Loan payable	-0-	34,287	34,287	33,373
Accumulated compensated absences	5,193	10,386	15,579	23,852
Utility deposits	120,538	-0-	120,538	114,173
Total Current Liabilities	282,600	83,286	365,886	426,783
Noncurrent Liabilities:				
Accumulated compensated absences	7,243	14,486	21,729	-0-
Loan payable	-0-	749,856	749,856	784,143
TOTAL LIABILITIES	289,843	847,628	1,137,471	1,210,926
NET ASSETS				
Invested in capital assets, net of related debt	1,114,454	1,210,194	2,324,648	2,313,139
Unrestricted (Deficit)	313,356	(28,882)	284,474	172,869
TOTAL NET ASSETS	1,427,810	1,181,312	2,609,122	2,486,008
TOTAL LIABILITIES AND NET ASSETS	\$ 1,717,653	\$ 2,028,940	\$ 3,746,593	\$ 3,696,934

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS – PROPRIETARY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Summarized Comparative Data for the Year Ended December 31, 2009)

	Electric Fund	Water and Sewer Fund	Totals	
			2010	2009 *
OPERATING REVENUES				
User service charges	\$ 2,584,753	\$ 668,967	\$ 3,253,720	\$ 2,854,390
Other operating revenue	43,139	29,555	72,694	89,320
Total Operating Revenue	<u>2,627,892</u>	<u>698,522</u>	<u>3,326,414</u>	<u>2,943,710</u>
OPERATING EXPENSES				
Electric purchased	1,727,703	-0-	1,727,703	1,497,883
Utility tax	13,875	-0-	13,875	8,753
Sewer charges	-0-	281,251	281,251	225,195
System upgrades and maintenance	36,064	41,810	77,874	98,369
Salaries and wages	76,089	152,177	228,266	228,347
Employee benefits	20,833	41,665	62,498	78,292
Depreciation	73,078	96,852	169,930	169,010
Supplies	7,148	31,086	38,234	39,853
Administration expenses	4,558	6,966	11,524	6,387
Professional services	26,670	2,149	28,819	30,040
Total Operating Expenses	<u>1,986,018</u>	<u>653,956</u>	<u>2,639,974</u>	<u>2,382,129</u>
OPERATING INCOME	<u>641,874</u>	<u>44,566</u>	<u>686,440</u>	<u>561,581</u>
NONOPERATING REVENUES (EXPENSES)				
Interest income	1,795	-0-	1,795	435
Interest expense	-0-	(21,196)	(21,196)	(22,893)
Total Nonoperating Revenues (Expenses)	<u>1,795</u>	<u>(21,196)</u>	<u>(19,401)</u>	<u>(22,458)</u>
INCOME BEFORE TRANSFERS AND CONTRIBUTIONS	<u>643,669</u>	<u>23,370</u>	<u>667,039</u>	<u>539,123</u>
Transfers in	-0-	29,252	29,252	-0-
Transfers out	<u>(573,177)</u>	<u>-0-</u>	<u>(573,177)</u>	<u>(775,490)</u>
CHANGE IN NET ASSETS	<u>70,492</u>	<u>52,622</u>	<u>123,114</u>	<u>(236,367)</u>
NET ASSETS, BEGINNING OF YEAR	<u>1,357,318</u>	<u>1,128,690</u>	<u>2,486,008</u>	<u>2,722,375</u>
NET ASSETS, END OF YEAR	<u>\$ 1,427,810</u>	<u>\$ 1,181,312</u>	<u>\$ 2,609,122</u>	<u>\$ 2,486,008</u>

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
STATEMENT OF CASH FLOWS – PROPRIETARY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Summarized Comparative Data for the Year Ended December 31, 2009)

	Electric Fund	Water and Sewer Fund	Totals	
			2010	2009 *
CASH FLOWS FROM OPERATING ACTIVITIES:				
Received from customers	\$ 2,659,482	\$ 701,885	\$ 3,361,367	\$ 2,941,016
Paid to suppliers for goods and services	(1,814,134)	(446,952)	(2,261,086)	(1,775,665)
Paid to employees for services	(90,914)	(178,721)	(269,635)	(328,176)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>754,434</u>	<u>76,212</u>	<u>830,646</u>	<u>837,175</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Due from other funds	(6,718)	-0-	(6,718)	-0-
Transfers in	-0-	29,252	29,252	-0-
Transfers out	(573,177)	-0-	(573,177)	(775,490)
NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES	<u>(579,895)</u>	<u>29,252</u>	<u>(550,643)</u>	<u>(775,490)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:				
Loan payment	-0-	(33,373)	(33,373)	(32,484)
Acquisition and construction of capital assets	(74,167)	(73,899)	(148,066)	-0-
Interest paid	-0-	(22,011)	(22,011)	(22,901)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(74,167)</u>	<u>(129,283)</u>	<u>(203,450)</u>	<u>(55,385)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest income	1,795	-0-	1,795	435
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>1,795</u>	<u>-0-</u>	<u>1,795</u>	<u>435</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	102,167	(23,819)	78,348	6,735
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>410,722</u>	<u>34,847</u>	<u>445,569</u>	<u>438,834</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 512,889</u>	<u>\$ 11,028</u>	<u>\$ 523,917</u>	<u>\$ 445,569</u>
CASH FLOWS FROM OPERATING ACTIVITIES:				
Operating income	\$ 641,874	\$ 44,566	\$ 686,440	\$ 561,581
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	73,078	96,852	169,930	169,010
Changes in assets and liabilities:				
Decrease (Increase) in accounts receivable	25,225	3,363	28,588	(2,694)
(Increase) in inventory	(6,228)	(9,064)	(15,292)	(7,583)
Decrease (Increase) in prepaid expenses	645	(398)	247	4,464
Increase (Decrease) in accounts payable	7,467	(74,228)	(66,761)	128,984
(Decrease) Increase in accrued salaries and benefits	1,920	5,753	7,673	(17,565)
Increase (Decrease) in compensated absences	4,088	9,368	13,456	(3,972)
Increase in utility deposits	6,365	-0-	6,365	4,950
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 754,434</u>	<u>\$ 76,212</u>	<u>\$ 830,646</u>	<u>\$ 837,175</u>

* Restated for comparative purposes.

The accompanying notes are an integral part of these financial statements.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Town of Clayton complies with generally accepted accounting principles ("GAAP"). GAAP includes all relevant Governmental Accounting Standards Board ("GASB") pronouncements. The accounting and reporting framework and the more significant accounting policies are discussed in subsequent subsections of this Note.

Financial Reporting Entity

The Town of Clayton, Delaware (the "Town") was incorporated in 1887 under the provisions of the State of Delaware. The Town operates under a Council form of government and provides the following services as authorized by its charter: public safety, public works, utilities, licensing and inspection, and general government.

The Government Accounting Standards Board established the criteria for determining the activities, organizations and functions of government to be included in the financial statements of the reporting entity. The criteria used in determining whether such organizations should be included in the Town's financial reporting entity are financial interdependences, selection of governing authority, designation of management, ability to significantly influence operations, accountability for fiscal matters, scope of public service and special financing relationships.

The Town has determined that no other outside agency meets the above criteria and; therefore, no other agency has been included as a component unit in the Town's financial statements. In addition, the Town is not aware of any entity which would exercise such oversight which would result in the Town being considered a component unit of the entity.

Entity-wide And Fund Financial Statements

The entity-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the Town. Governmental activities, which normally are supported by taxes and inter-governmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers who purchase, use or directly benefit from goods, services or privileges provided by a function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as nonmajor funds.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Measurement Focus, Basis Of Accounting And Financial Statement Presentation

The entity-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items (nonexchange transactions) are recognized as revenue as soon as all eligibility requirements imposed by the provider have been satisfied.

The entity-wide financial statements report net assets in one of three components. Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of borrowing attributable to acquiring, constructing or improving those assets. Net assets are reported as restricted when constraints placed on net asset use are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. Those restrictions affect net assets arising from special revenue and capital funds. Unrestricted net assets consist of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted."

Except for interfund activity and balances between the funds that underlie governmental activities and the funds that underlie business-type activities, which are reported as transfers and internal balances, the effect of interfund activity has been removed from these statements.

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they become both measurable and available. Revenues are considered to be available if they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Town considers property tax revenue to be available if collected within 60 days of the end of the fiscal period. Revenue from federal, state and other grants designated for payment of specific Town expenditures is recognized when the related expenditures are incurred; accordingly, when such funds are received, they are reported as deferred revenues until earned. Other revenues, including charges for services and miscellaneous revenues, are recorded as revenue when received in cash because they generally are not measurable until actually received.

Expenditures are recorded when the related fund liability is incurred (upon receipt of goods or services), except for claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds.

The Town reports the following major governmental funds:

General Fund – This fund is used to account for the general operating activities of the Town. General government, public safety, public works, and licensing and inspections are financed through this fund with receipts from general property taxes, transfer taxes, licenses and permits, investment interest, fines, charges for current services, intergovernmental and other revenue.

Impact Fees Fund – This fund is used to account for impact fees until they are transferred to the appropriate fund for specific, eligible projects.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Nonmajor Governmental Funds – In addition to the above major governmental funds, the Town includes the Municipal Street Aid, S.A.L.L.E., E.I.D.E., and seized asset illegal drug enforcement funds in its financial statements.

Proprietary funds are accounted for using the accrual basis of accounting. These funds account for operations that are financed primarily by user charges. The economic resource focus concerns determining costs as a means of maintaining the capital investment and management control. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

These funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods or services in connection with the proprietary fund's principal ongoing operations. The principal operating revenues of the Town's proprietary funds are electric and water/sewer charges. Operating expenses for the Town's proprietary funds include salaries, employee benefits, production costs, supplies and administrative costs. All revenues or expenses not meeting this definition are reported as nonoperating revenues and expenses.

The Town reports the following major proprietary funds:

Electric Fund – Used to account for the operation of an electric distribution system.

Water and Sewer Fund – Used to account for the operation of a water supply and sewage collection system.

In accordance with the Financial Standards Accounting Board's Accounting Standards Codification ("FASB ASC"), the entity-wide and business-type activities and proprietary funds of the Town follow the standards of accounting and financial reporting issued on or before November 30, 1989, to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board ("GASB"). The Town also has the option to follow subsequent private-sector guidance for its business-type activities and proprietary funds with certain limitations, but has elected not to do so.

Cash And Cash Equivalents

For the purpose of the statement of cash flows, the proprietary funds consider all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Allowance For Doubtful Accounts

The Town of Clayton's water, sewer and electric utilities experience very small losses from uncollectible accounts. Water and sewer fees constitute a lien against real property and usually can be collected in full when title transfers. Only balances that remain after tax sales are written off each year. Electric fees do not constitute a lien; however, maintenance of adequate customer deposits, monthly billing and diligent collection procedures minimize losses from uncollectible accounts. Accordingly, an allowance for doubtful accounts has not been established by the Town for its proprietary funds.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Inventories And Prepaid Expenses

Inventories of business-type activities and proprietary fund types are presented at the lower of cost or market on a first-in, first-out basis, and are expensed when used. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses.

Capital Assets

Capital assets, including property, plant and equipment, are reported in the applicable governmental or business-type activities columns in the entity-wide financial statements. During the year ended December 31, 2007, the Town adopted a capitalization threshold of \$5,000 with an estimated life in excess of one year. Capital assets placed in service prior to January 1, 2007, with a cost of less than \$5,000 will continue to be depreciated until the asset is fully depreciated or disposed. Capital assets may be purchased or constructed and are recorded at cost. Donated capital assets are recorded at estimated fair value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed, inclusive on ancillary costs.

GASB Statement No. 34 permits Phase III local governments to elect not to report infrastructure retroactively and report general infrastructure prospectively only. Management has assessed the impact of infrastructure capitalization on the financial statements and has determined that the cost outweighs the benefit of reporting the Town's infrastructure retroactively.

Capital assets of the Town are depreciated using the straight-line method over the estimated useful lives of the related assets as follows:

Buildings	40 years
Vehicles	5-8 years
Land improvements	20 years
Machinery and equipment	5-10 years

Compensated Absences

Regular, full-time employees are allowed sick leave on the basis of 10 days per year. Each January, employees have the option to continue accruing sick leave or be paid for unused sick leave from the previous year. Upon termination or retirement, an employee shall be paid a maximum of 45 days of accrued unused sick leave.

Regular, full-time employees accrue vacation leave on the basis of two weeks per year after completion of one year of continuous service. After three years of continuous service, two weeks vacation will be accrued. After six years of continuous service, three weeks vacation will be accrued. After 14 years of continuous service, four weeks vacation will be accrued. If an employee resigns or is terminated for any reason including dismissal or dies with unused annual leave credit, the employee, or in the case of his/her death, his/her estate, shall be paid for unused vacation time. Employees leaving the Town's employment on or before the 15th of a month will not receive credit for that month. Those employees departing the Town's employment after the 15th of a month will receive full credit for that month.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Compensated Absences (cont'd)

Accumulated vacation and sick leave is accrued when incurred in the entity-wide financial statements and proprietary fund types. A liability is reported in the governmental funds only if it is expendable from available financial resources. Historically, the General Fund has been responsible for liquidation of compensated absences associated with governmental fund activities. Compensated absences associated with proprietary funds are liquidated from the fund in which the liability was generated.

Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. The proprietary funds report the same three components of net assets as do the entity-wide financial statements. When both restricted and unrestricted resources are available for use, it is the Town's policy to use restricted resources first and then unrestricted resources as they are needed.

Property Taxes

Property taxes attach as an enforceable lien on property when levied. All liens continue until property taxes are paid in full. Taxes are levied on July 1 and are payable on or before September 30. Taxes paid after the payable date are assessed interest at one percent per month after the due date. The Town bills and collects its own property taxes. Town property tax revenues are recognized on a pro rata basis. Delinquent taxes are considered fully collectible; therefore, no allowance for uncollectible taxes is provided. The property tax rate for 2010 was 65 cents per \$100 of assessed value.

Use Of Estimates In The Preparation Of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Comparative Data

Comparative totals for the prior year have been presented in the accompanying financial statements in order to provide an understanding of changes in the Town's financial position and operations. However, presentation of prior year totals by fund and activity type have not been presented in each of the statements since their inclusion would make the statements unduly complex and difficult to read. Summarized comparative information should be read in conjunction with the Town's financial statements for the year ended December 31, 2009, from which the summarized information was derived.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Information

The Town follows these procedures in establishing the budgetary data reflected in the financial statements:

- a. Formal budgetary integration is employed as a management control device during the year for the General Fund. This budget is adopted on a basis consistent with generally accepted accounting principles.
- b. The Town Council adopts legal annual budgets for the General Fund and Proprietary Funds. The Town Council also adopts legal project length budgets for its Impact Fees Fund and certain nonmajor governmental funds. Since project periods may differ from the Town's fiscal year, a comparison of budgetary information for the combined Impact Fees Fund and certain nonmajor governmental funds would not be meaningful and has not been presented in the accompanying financial statements.
- c. Management is authorized to transfer budget amounts between departments within any fund; however, any revisions that alter the total appropriations of any fund must be approved by the Town Council. Therefore, the level of budgetary responsibility is by total appropriations; however, for report purposes, this level has been expanded to a functional basis.
- d. Unused appropriations for all of the above annually budgeted funds lapse at year end.
- e. For 2010 there were no revisions to any legally adopted budgets.

Excess of Expenditures Over Appropriations

For the year ended December 31, 2010, the General Fund incurred expenditures in excess of appropriations in the following functions:

General government	\$ 83,260
Public works	\$365,833
Capital outlay	\$ 2,345

All excess of expenditures over appropriations were funded by higher than anticipated revenues, transfers from other funds and the use of existing fund balances.

NOTE 3 PRIOR PERIOD ADJUSTMENT

During the current year audit, the Town became aware of items that were recorded in error during the previous year audit:

A police car was recorded for an incorrect amount and later written off as disposed of when it actually had not been disposed of. The effect of this entry resulted in the following:

Increase fixed assets	\$ 22,034
Increase loans payable	\$ 15,301
Increase accumulated depreciation	\$ 4,040
Increase to general fund retained earnings	\$ 2,693

This resulted in prior year expenses being overstated by \$2,693.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 3 PRIOR PERIOD ADJUSTMENT (con't)

A police motorcycle had been previously recorded as a leased asset when, in fact, it was a lease purchase. To reclassify and place this asset on the Town's fixed asset schedule, the entry resulted in the following:

Increase fixed assets	\$ 16,296
Increase loans payables	\$ 10,048
Increase accumulated depreciation	\$ 6,243
Increase to general fund retained earnings	\$ 4

This resulted in prior year expenses being overstated by \$4.

An impact fees fund bank account had been improperly included with the general fund. This resulted in the following:

Decrease to general fund retained earnings	\$137,171
Increase to impact fees fund retained earnings	\$137,171

This had no impact on revenues or expenses.

An inventory item had been undervalued which resulted in the following entry:

Increase inventory	\$ 5,000
Increase general fund retained earnings	\$ 5,000

This resulted in prior year expenses being overstated by \$5,000.

NOTE 4 CASH, CASH EQUIVALENTS AND INVESTMENTS

The Town of Clayton as a depositor and an investor generally requires full and continuous collateralization based upon fair value in the form of:

- Obligations of or guaranteed by the United States of America, or
- Obligations of the Federal National Mortgage Association, the Federal Home Mortgage Corporation, Public Housing Authority or an agency or instrumentality of the United States of America, or
- General or revenue obligations of the State of Delaware or its municipalities, subdivisions, public housing authorities or any agency or instrumentality of the State of Delaware.

As an investor, the Town of Clayton may invest in any of the above cited instruments and/or certificates of deposit or repurchase agreements fully collateralized by one or more of the above-cited instruments.

The Town maintains a cash and investment pool that is available for use by all funds. This pool is displayed on the balance sheet and the statement of net assets as cash and cash equivalents. Deposits and investments of governmental and proprietary funds are reported at fair value.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 4 CASH, CASH EQUIVALENTS AND INVESTMENTS (cont'd)

Deposits

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned. The Town does not have a policy regarding custodial credit risk for deposits. At December 31, 2010, the carrying amount of the Town's deposits was \$3,350,809 and the bank balance was \$3,352,111. Of the bank balance, \$251,069 was covered by federal depository insurance, and \$3,101,042 was uninsured and collateralized with securities held by the pledging financial institution's trust department, but not in the Town's name.

NOTE 5 CAPITAL ASSETS

The capital asset activity for the year ended December 31, 2010, was as follows:

	Beginning Balance*	Increase	Decrease	Ending Balance
Governmental Activities:				
Capital assets not being depreciated:				
Land	\$ 433,916	\$ -0-	\$ -0-	\$ 433,916
Total Capital Assets Not Being Depreciated	433,916	-0-	-0-	433,916
Capital assets being depreciated:				
Buildings	289,794	-0-	-0-	289,794
Improvements	130,997	-0-	-0-	130,997
Vehicles	481,338	206,191	16,003	671,526
Machinery and equipment	405,708	16,927	-0-	422,635
Total Capital Assets Being Depreciated	1,307,837	223,118	16,003	1,514,952
Accumulated depreciation:				
Buildings	105,570	6,269	-0-	111,839
Land Improvements	32,058	5,509	-0-	37,567
Vehicles	365,380	81,196	16,003	430,573
Machinery and equipment	338,544	25,557	-0-	364,101
Total Accumulated Depreciation	841,552	118,531	16,003	944,080
Total Capital Assets Being Depreciated, Net	466,285	104,587	-0-	570,872
Governmental Activities Assets, Net	\$ 900,201	\$ 104,587	\$ -0-	\$ 1,004,788
Business-type Activities:				
Capital assets being depreciated:				
Buildings and infrastructure	\$ 4,127,138	\$ 123,566	\$ -0-	\$ 4,250,704
Vehicles	219,455	-0-	-0-	219,455
Machinery and equipment	94,379	24,500	-0-	118,879
Total Capital Assets Being Depreciated	4,440,972	148,066	-0-	4,589,038

* Restated for comparative purposes.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 5 CAPITAL ASSETS (cont'd)

	Beginning Balance*	Increase	Decrease	Ending Balance
Accumulated depreciation:				
Buildings and improvements	1,185,339	126,144	-0-	1,311,483
Vehicles	111,959	34,746	-0-	146,705
Machinery and equipment	13,019	9,040	-0-	22,059
Total Accumulated Depreciation	<u>1,310,317</u>	<u>169,930</u>	<u>-0-</u>	<u>1,480,247</u>
Business-type Activities Assets, Net	<u>\$ 3,130,655</u>	<u>\$ (21,864)</u>	<u>\$ -0-</u>	<u>\$ 3,108,791</u>

* Restated for comparative purposes.

Depreciation expense was charged to the functions as follows:

Governmental Activities:		
General government		\$ 20,093
Public safety		45,313
Public works		<u>42,840</u>
Total Depreciation Expense – Governmental Activities		<u>\$ 108,246</u>
Business-type Activities:		
Electric		\$ 73,078
Water		<u>96,852</u>
Total Depreciation Expense – Business-type Activities		<u>\$ 169,930</u>

NOTE 6 CHANGES IN COMPENSATED ABSENCES

	Beginning Balance*	Increase	Decrease	Ending Balance
Governmental Activities:				
Accumulated compensated absences	<u>\$ 38,142</u>	<u>\$ 80,469</u>	<u>\$ 67,396</u>	<u>\$ 51,215</u>
Business-type Activities:				
Accumulated compensated absences				
Electric	\$ 8,348	\$ 8,470	\$ 4,382	\$ 12,436
Sewer	<u>15,504</u>	<u>16,940</u>	<u>7,572</u>	<u>24,872</u>
	<u>\$ 23,852</u>	<u>\$ 25,410</u>	<u>\$ 11,954</u>	<u>\$ 37,308</u>

* Restated for comparative purposes.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 7 INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS

The composition of interfund balances as of December 31, 2010, is as follows:

Due To	Amount	Due From	Amount
Impact Fees Fund	\$ 554,945	General Fund	\$ 561,663
Electric Fund	<u>6,718</u>		<u></u>
Total	<u>\$ 561,663</u>		<u>\$ 561,663</u>

Interfund balances between funds represent temporary loans recorded at year end subsequent to a final allocation of expenses. The balances generally are paid shortly after year end.

The composition of interfund transfers for the year ended December 31, 2010, was as follows:

	<u>Transfer In</u>	<u>Transfer Out</u>
Impact Fees Fund	\$ 433,231	\$ 24,500
General Fund	135,194	-0-
Electric Fund	-0-	573,177
Water and Sewer Fund	<u>29,252</u>	<u>-0-</u>
Total	<u>\$ 597,677</u>	<u>\$ 597,677</u>

Transfers from the electric fund and water and sewer funds to the impact fees fund and general fund were to subsidize those funds' operating activities.

NOTE 8 LONG-TERM DEBT

A schedule of changes in the long-term debt is as follows:

	<u>Beginning Balance</u>	<u>Prior Period Adjustment</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Governmental Activities:					
Loan payable – Sparta Commercial Services	\$ -0-	\$ 10,048	\$ -0-	\$ 2,757	\$ 7,291
Loan payable – ALD Automotive	-0-	15,301	-0-	7,345	7,956
Loan payable – Ford Motor Credit Company	<u>-0-</u>	<u>-0-</u>	<u>25,303</u>	<u>-0-</u>	<u>25,303</u>
	<u>\$ -0-</u>	<u>\$ 25,349</u>	<u>\$ 25,303</u>	<u>\$ 10,102</u>	<u>\$ 40,550</u>

The loan payable consists of three loans. Two of these loans had been previously treated as lease expenses but have been booked as prior period adjustments in the current year financials.

The loan payable between Sparta Commercial Services, Inc. and the Town of Clayton Police department is for a 2008 police motorcycle. The loan was entered into on February 7, 2008, and bears interest at 11 percent payable on March 17 in the amount of \$3,736. The loan matures on March 17, 2011, with a balloon payment of \$8,000.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 8 LONG-TERM DEBT (cont'd)

The loan payable between ALD Automotive and the Town of Clayton Police department is for a 2009 police vehicle. The loan was entered into on February 15, 2009, and bears interest at 6 percent payable on February 15 in the amount of \$8,075. The loan matures on February 15, 2011.

The loan payable between Ford Motor Credit Company and the Town of Clayton Police department is for a 2011 police vehicle. The loan was entered into on November 4, 2010, and bears interest at 6.5 percent payable on January 5 in the amount of \$9,071. The loan matures on January 5, 2013.

Maturities of debt obligations, including interest, are as follows:

Year Ended December 31,	<u>Principle</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 24,035	\$ 1,111	\$ 25,146
2012	7,998	1,073	9,071
2013	<u>8,517</u>	<u>554</u>	<u>9,071</u>
	<u>\$ 40,550</u>	<u>\$ 2,738</u>	<u>\$ 43,288</u>

A schedule of changes in the long-term debt is as follows:

	<u>Beginning Balance</u>	<u>Prior Period Adjustment</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Business-type Activities:					
Loan payable	<u>\$ 817,516</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 33,373</u>	<u>\$ 784,143</u>

The loan payable is issued by the Delaware Department of Natural Resources and Environmental Control and administered by the Delaware Department of Health and Social Services to finance the arsenic removal project. The revolving loan converted to permanent financing on August 1, 2008, and bears interest at 3.72 percent payable on February 1 and August 1. The loan matures on August 1, 2028.

Maturities of debt obligations, including interest, are as follows:

Year Ended December 31,	<u>Principle</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 34,287	\$ 21,097	\$ 55,384
2012	35,227	20,157	55,384
2013	36,190	19,194	55,384
2014	37,182	18,202	55,384
2015	38,200	17,184	55,384
2016-2020	207,279	69,641	276,920
2021-2025	237,256	39,664	276,920
2026-2028	<u>158,522</u>	<u>7,631</u>	<u>166,153</u>
	<u>\$ 784,143</u>	<u>\$ 212,770</u>	<u>\$ 996,913</u>

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 9 PENSIONS

Delaware County and Municipal Police/Firefighter Pension Plan

The Town contributes to the Delaware County and Municipal Police/Firefighter Pension Plan, which is a cost-sharing multiple-employer defined benefit plan administered by the Delaware Public Employees' Retirement System. The plan covers Town police employees hired on or after February 1, 1993. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The contribution policy is set by State law and requires contributions by active members and participating employers. Plan members are required to contribute seven percent of base compensation. The contributions required of participating employers are based on an actuarial valuation and are expressed as a percentage of annual covered payroll during the period from which the amount is determined. The Town's contributions to the plan for the years ended December 31, 2010, 2009, and 2008, were \$45,907, \$51,211, and \$46,559, respectively. The Delaware Public Employees' Retirement System issues a separate plan financial report that includes financial statements for the plan. That report may be obtained by writing to the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite No. 1, 860 Silver Lake Boulevard, Dover, Delaware 19904-2402.

State Employees' Pension Plan

The Town contributes to the State Employees' Pension Plan, which is a cost-sharing multiple-employer defined benefit plan administered by the Delaware Public Employees' Retirement System. The plan covers full-time or regular part-time employees. Benefit provisions of the plan are established under the provisions of State law and may be amended by an act of the State legislature. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The contribution policy is set by State law and requires contributions by active members and participating employers. Plan members are required to contribute three percent of total compensation that exceeds \$6,000 per year. The contributions required of participating employers are based on an actuarial valuation and are expressed as a percentage of annual covered payroll during the period from which the amount is determined. The Town's contributions to the plan for the years ended December 31, 2010, 2009, and 2008, were \$26,967, \$34,613, and \$24,125, respectively. The Delaware Public Employees Retirement System issues a separate plan financial report that includes financial statements of the plan. That report may be obtained by writing to the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite No. 1, 860 Silver Lake Boulevard, Dover, Delaware 19904-2402.

NOTE 10 COMMITMENTS AND CONTINGENCIES

Government Grants and Awards

The Town participates in state and county assisted grant programs. These programs are subject to program compliance audits by the grantors or their representatives. The Town is potentially liable for any expenditures which may be disallowed pursuant to the terms of these grant programs. Management is not aware of any material items of noncompliance which would result in the disallowance of program expenditures.

TOWN OF CLAYTON
NOTES TO THE FINANCIAL STATEMENTS

NOTE 10 COMMITMENTS AND CONTINGENCIES (cont'd)

Delaware Municipal Electric Corporation

The Town is a member of the Delaware Municipal Electric Corporation ("DEMEC"). DEMEC is a public corporation constituted as a joint action agency and a wholesale electric utility. DEMEC was established in 1979 and represents nine municipal electric distribution utilities located in the State of Delaware. DEMEC provides full requirements wholesale electric power supply service to seven of the nine members, including the Town, through the operation of owned generation assets and various contractual wholesale supply contracts with external parties.

The Town purchases 100 percent of its electric supply requirements from DEMEC under a long-term full requirements service contract that became effective January 1, 2004, and which will remain in effect unless terminated upon one year's written notice by either party. The obligation of the Town to purchase and pay for full requirements service, including its allocated costs under any then current forward contract for capacity and energy between DEMEC and a third party in effect as of the date of notice of termination, shall survive the termination of this agreement.

The Town has entered into a separate power sales agreement effective May 1, 2001, to purchase an interest in the capacity produced by Unit No. 1 of the Warren F. "Sam" Beasley Power Station located in Smyrna, Delaware, owned by DEMEC. The Town is entitled to a percentage of all power supply and ancillary products generated from the existing nominal 45 MW natural gas fired combustion turbine generator for the useful life of the facility.

Under the terms of the various agreements, DEMEC is authorized to act as agent for the Town in all matters relating to the acquisition and delivery of its wholesale power supply and management of energy cost risk on behalf of the Town in the deregulated energy markets.

NOTE 11 RISK MANAGEMENT

The Town maintains commercial insurance coverage for risk of losses relating to general, automotive, police professional, public officials and crime. There have been no significant changes in coverage, and there have been no losses above insurance limits during the past year.

NOTE 12 SUBSEQUENT EVENTS

The Town has evaluated all subsequent events through March 2, 2011, the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION

**TOWN OF CLAYTON
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Original and Final Appropriated Budget	Actual Amounts (Budgetary Basis)	Variance Positive (Negative)
REVENUES			
Taxes:			
Property taxes	\$ 280,500	\$ 276,281	\$ (4,219)
Transfer taxes	95,000	84,471	(10,529)
Charges for services	248,000	280,081	32,081
Intergovernmental	9,861	96,040	86,179
Licenses and fees	21,850	6,366	(15,484)
Fines and forfeits	70,750	48,836	(21,914)
Franchise fees	15,000	16,183	1,183
Interest income	1,000	2,237	1,237
Miscellaneous	5,500	14,534	9,034
TOTAL REVENUES	<u>747,461</u>	<u>825,029</u>	<u>77,568</u>
EXPENDITURES			
Current:			
General government	487,721	404,461	83,260
Public safety	648,577	717,879	(69,302)
Public works	655,618	289,785	365,833
Licensing and inspection	68,109	88,872	(20,763)
Debt service:			
Principal	-0-	10,102	(10,102)
Interest	-0-	1,709	(1,709)
Capital outlay	187,143	184,789	2,354
TOTAL EXPENDITURES	<u>2,047,168</u>	<u>1,697,597</u>	<u>349,571</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(1,299,707)</u>	<u>(872,568)</u>	<u>427,139</u>
OTHER FINANCING SOURCES			
Proceeds from sale of capital assets	-0-	5,000	5,000
Transfers in	160,000	135,194	(24,806)
Loan proceeds	-0-	25,303	25,303
TOTAL OTHER FINANCING SOURCES	<u>160,000</u>	<u>165,497</u>	<u>5,497</u>
NET CHANGE IN FUND BALANCE	(1,139,707)	(707,071)	432,636
FUND BALANCE, BEGINNING OF YEAR	740,854	740,854	-0-
PRIOR PERIOD ADJUSTMENT	<u>-0-</u>	<u>(129,474)</u>	<u>(129,474)</u>
FUND BALANCE, END OF YEAR	<u>\$ (398,853)</u>	<u>\$ (95,691)</u>	<u>\$ 303,162</u>

* Restated for comparative purposes.

COMBINING NONMAJOR FUND STATEMENTS

TOWN OF CLAYTON
COMBINING BALANCE SHEET – NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2010

	Municipal Street Aid Fund	S.A.L.L.E. Fund	E.I.D.E. Fund	Seized Asset/ Illegal Drug Enforcement Fund	Total
ASSETS					
Cash and cash equivalents	\$ 113,781	\$ 1	\$ -0-	\$ 1,069	\$ 114,851
TOTAL ASSETS	<u>\$ 113,781</u>	<u>\$ 1</u>	<u>\$ -0-</u>	<u>\$ 1,069</u>	<u>\$ 114,851</u>
LIABILITIES AND FUND BALANCES					
LIABILITIES					
	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
FUND BALANCES					
Reserved, designated for:					
Police expenditures	-0-	1	-0-	1,069	1,070
Public works expenditures	113,781	-0-	-0-	-0-	113,781
TOTAL FUND BALANCES	<u>113,671</u>	<u>1</u>	<u>-0-</u>	<u>1,069</u>	<u>114,851</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 113,781</u>	<u>\$ 1</u>	<u>\$ -0-</u>	<u>\$ 1,069</u>	<u>\$ 114,851</u>

TOWN OF CLAYTON
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES – NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2010

	Municipal Street Aid Fund	S.A.L.L.E. Fund	E.I.D.E. Fund	Seized Asset/ Illegal Drug Enforcement Fund	Total
REVENUES					
Intergovernmental	\$ 31,036	\$ 4,129	\$ -0-	\$ 644	\$ 35,809
Interest income	457	1	2	1	461
TOTAL REVENUES	<u>31,493</u>	<u>4,130</u>	<u>2</u>	<u>645</u>	<u>36,270</u>
EXPENDITURES					
Current:					
Public safety	-0-	4,134	4,257	-0-	8,391
Public works	26,124	-0-	-0-	-0-	26,124
TOTAL EXPENDITURES	<u>26,124</u>	<u>4,134</u>	<u>4,257</u>	<u>-0-</u>	<u>34,515</u>
CHANGE IN FUND BALANCES	5,369	(4)	(4,255)	645	1,755
FUND BALANCES, BEGINNING OF YEAR	<u>108,412</u>	<u>5</u>	<u>4,255</u>	<u>424</u>	<u>113,096</u>
FUND BALANCES, END OF YEAR	<u>\$ 113,781</u>	<u>\$ 1</u>	<u>\$ -0-</u>	<u>\$ 1,069</u>	<u>\$ 114,851</u>

OTHER REPORTS

REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED
ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

March 2, 2011

To the Honorable Mayor and Town Council
Town of Clayton
Clayton, Delaware

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Town of Clayton, Delaware, as of and for the year ended December 31, 2010, which collectively comprise the Town's basic financial statements and have issued our report thereon dated March 2, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Town of Clayton's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town of Clayton's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We consider the deficiencies described in the accompany schedule of findings and recommendations as items #06-1, #06-2, #08-1, #09-1, and #09-2 to be significant deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. However, the significant deficiencies, described in the accompanying schedule of findings and recommendations as items #06-1, #06-2, #08-1, and #09-1 are considered to be material weaknesses.

To the Honorable Mayor and Town Council
Town of Clayton
March 2, 2011

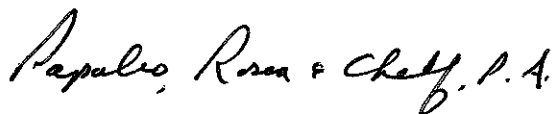
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Town of Clayton's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Town of Clayton in a separate letter dated March 2, 2011.

The Town of Clayton's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Town of Clayton's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, City Council, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



PAPALEO, ROSEN & CHELF, PA

TOWN OF CLAYTON

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

STATUS OF PRIOR YEAR FINDINGS

06-1 FINANCIAL REPORTING

Condition: The Town does not report financial data reliably in accordance with generally accepted accounting principles. Reporting deficiencies noted during our audit procedures are as follows:

- The Town does not maintain financial data on a fund-based presentation. Authoritative accounting and financial reporting standards for state and local governments require that financial statements be accompanied by a fund-based presentation. A fund is a separate, self-balancing set of accounts used to account for resources that are segregated for specific purposes in accordance with special regulations, restrictions or limitations.
- The Town lacks employees or management who have the qualifications and training to apply generally accepted accounting principles to the Town's financial transactions or in the preparation of its financial statements. As a result, the Town relies on its auditor to record adjusting journal entries, maintain certain subsidiary ledgers and draft audited financial statements in accordance with generally accepted accounting principles.

Criteria: The Governmental Accounting Standards Board requires the financial reporting of governments to be in accordance with generally accepted accounting principles.

Cause: Lack of oversight by the Town Council and management over the financial reporting requirements necessary to comply with generally accepted accounting principles.

Effect: The Town's current financial reporting structure does not allow for the Town to initiate, process, or report financial data in accordance with generally accepted accounting principles.

Recommendation: The Town needs to evaluate its current financial reporting structure given the state of growth it is currently experiencing. Management and the Town Council need to take appropriate measures in respect to the above-noted deficiencies in financial reporting. We recommended that the Town explore the cost benefit of employing the services of a person or outside agency with the necessary background and knowledge to consistently apply generally accepted accounting principles to the financial data of the Town.

Status: During our current year audit, we noted that the Town still does not maintain financial data on a fund-based presentation as of December 31, 2010. In addition, the Town continued to rely on its auditor to record adjusting journal entries and draft financial statements in accordance with generally accepted accounting principles. Currently, the Town is evaluating the above-noted deficiencies to determine a cost-effective approach to resolve each deficiency given the current organizational structure of the Town.

Corrective Action Plan: The Town currently contracts with an outside individual to prove and close out its books on a monthly basis. Management will explore the option of retaining this same individual to record adjusting entries prior to the Town's being audited.

TOWN OF CLAYTON

SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONT'D)

STATUS OF PRIOR YEAR FINDINGS

06-2 LACK OF SEGREGATION OF DUTIES AND INTERNAL CONTROL-RELATED ISSUES

Condition: The current structure of the Town's operations does not employ proper segregation of duties or internal controls. Deficiencies noted during our audit procedures include, but are not limited to, the following:

- Mail is opened and cash receipts are listed by personnel having access to cash receipts and accounts receivable records.
- The general cashier function is not segregated from the general ledger and subsidiary ledger functions.
- Only one authorized signature is required for all checks. Dual signatures should be required on all checks over a specific amount.
- Custody of checks after signature and before mailing are handled by someone who is not independent of all payable, disbursing, cash, receiving and general ledger functions.
- Bank reconciliations are prepared by someone who is not independent of the cash receipts and disbursements functions.
- The billing function is not separate from the collection function.
- Personnel in the payables function are not independent of purchasing, disbursing, and general ledger functions.
- The person preparing the payroll is not independent of other payroll duties (e.g., timekeeping, distribution of checks) and has access to other payroll data.
- Payroll is not subject to final approval before payment by someone independent of payroll preparation and timekeeping.
- Journal entries are not supported by adequate documentation or approval by a responsible member of management or a Town official.

Criteria: Proper internal controls promote efficiency, reduce risk of asset loss and help to ensure the reliability of financial reporting.

Cause: Lack of oversight by the Town Council and management relevant to the internal control structure of the Town.

Effect: Material misstatements in relation to the financial reporting of the Town caused by error or fraud may occur and not be detected within a timely period by employees or Town officials in the normal course of performing their assigned functions.

Recommendation: Segregation of duties and the implementation of proper internal controls normally is difficult to accomplish within a small organization, but management and Town officials should be sensitive to areas that can be improved upon. Sometimes the cost outweighs the benefit of implementation depending on the size and structure of the organization. We recommended that management and the Town Council review the above-noted deficiencies and the current assignment of accounting functions. Where possible, duties should be segregated and internal controls set in place to help mitigate the risk of errors and fraud.

TOWN OF CLAYTON

SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONT'D)

STATUS OF PRIOR YEAR FINDINGS

Status: During our current year audit, we noted that the Town had not yet implemented processes relating to the lack of segregation of duties and internal control-related issues. The remaining lack of segregation of duties and internal control-related issues noted during the prior year audit are still applicable based on our current year audit procedures. In addition, during our current year audit procedures we discovered an employee that had been stealing cash. Management has addressed the theft and the employee is no longer employed by the Town of Clayton. We recommend that management and the Town Council evaluate each noted deficiency to determine whether the cost of implementation outweighs the benefits based on the Town's current organizational structure.

Corrective Action Plan: The Town of Clayton is a very small municipality. Many of these deficiencies have already been addressed with the change of personnel. Segregation of certain duties is difficult. The Town has put in place several checks and balances. Checks over \$2,000 are signed by two Council members. Payroll (does not include direct deposits) and accounts payable checks are presented to a Council member for review and signed by those with signature privileges.

08-1 CREDIT CARD RECEIPTS AND USAGE

Condition: The Town pays credit card invoices that are not supported by receipts and/or are made up of personal expenses.

Criteria: The Town should be paying invoices related to Town expenditures only.

Cause: Lack of oversight by the Town Council and management over the monitoring of credit card payments.

Effect: Without supporting documentation or evidence of a personal expense, there is a risk of overstatement of expenditures on the Town's financial statements or fraudulent activity by an employee(s).

Recommendation: The Town needs to evaluate its current credit card policy. Management and the Town Council need to take appropriate measures in respect to the above-noted deficiency. We recommended that the Town require a receipt for all credit card expenses. We further recommended that procedures be adopted to identify personal expenditures when they are incurred and to charge them back to the employees.

Status: During our current year audit, we noted that a majority of expenditures contained proper supporting documentation. We also noted that some expenditure had been deemed for personal expenses. The personal expenses have been repaid as evidence through additional testing. However, with the lack of supporting documentation for other credit card expenditures paid by the Town in 2010, this finding is still applicable for the current year.

Corrective Action Plan: The Town has adopted a credit card policy. With the change of personnel, all receipts are collected and verified that they are qualified expenses.

TOWN OF CLAYTON

SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONT'D)

STATUS OF PRIOR YEAR FINDINGS

08-2 FRAUD RISK ASSESSMENT

Condition: The Town does not have a risk assessment process in place.

Criteria: In light of the spate of notorious frauds involving large organizations in prior years, there may be a misperception that fraud affects only large organizations. However, fraud occurs in organizations of all sizes, and almost any employee may be capable of perpetrating a fraudulent act given the right set of circumstances. In fact, fraud may be a more significant problem for small companies.

Cause: Lack of oversight by the Town Council and management over the assessment of fraud risks.

Effect: Whereas the highly publicized frauds at large public companies involved fraudulent financial reporting, for small organizations, one of the primary fraud risks is the ever-present risk of misappropriation of assets (theft), particularly fraudulent cash disbursements. The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and inadequate controls to prevent or detect the fraud.

Recommendation: We recommended that the Town perform a risk assessment to identify, analyze and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the Town's internal control should include performance of this assessment, even though our annual financial statement audit includes consideration of fraud. The fraud risk assessment can be informal and performed by a management-level individual who has extensive knowledge of the Town that might be used in the assessment. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the Town, its environment (including industry and country-specific characteristics), and its processes. The fraud risk assessment process should consider the Town's vulnerability to misappropriation of assets. When conducting the self-assessment, questions such as the following can be considered:

- *What Individuals in the Town Have the Opportunity to Misappropriate Assets?* These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.
- *Are There Any Known Pressures That Would Motivate Employees with the Opportunity to Misappropriate Assets?* Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of employees with access to assets susceptible to misappropriation.
- *What Assets of the Town Are Susceptible to Misappropriation?*
- *Are There Any Known Internal Control Weaknesses That Would Allow Misappropriation of Assets to Occur and Remain Undetected?*

TOWN OF CLAYTON

SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONT'D)

STATUS OF PRIOR YEAR FINDINGS

- *How Could Assets Be Stolen?* Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious employees or vendors and cashing them for personal use. Inventory or other assets can be stolen through sales to fictitious customers. Assets can also be stolen by unauthorized trading in securities.
- *How Could Potential Misappropriation of Assets Be Concealed?* Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running through an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored (for example, fixed assets, inventory and consulting expenses).
- *What Factors Might Indicate That the Town Has a Culture or Environment That Would Enable Management or Employees to Rationalize Committing Fraud?*

Status: During our current year audit, we noted that the Town had not yet implemented a process for fraud risk assessment. This finding is still applicable for the current year.

Corrective Action Plan: The Council will review a risk assessment process for the Town.

CURRENT YEAR FINDINGS AND RECOMMENDATIONS

09-01 YEAR-END CLOSING PROCEDURES

Condition: The Town did not have the financial records ready prior to the commencement of the audit. We made several journal entries to accrue liabilities, to reclassify capital outlays, to record debt payments and to record transfers between funds.

Criteria: As described in Statement of Auditing Standards (SAS) No. 115, "Communicating Internal Control-Related Matters Identified in an Audit," the auditor is required to report to those charged with governance any deficiencies in internal control identified during the audit. Specifically, deficiencies in "controls over the period-end financial reporting process, including controls over procedures used to initiate, authorize, record and process journal entries into the general ledger" are to be reported.

Cause: Lack of procedures established for the completion of year-end closing procedures.

Effect: When the auditor is making the journal entries as well as conducting the audit, the perception of independence may arise.

Recommendation: We recommend that the Town establish and implement procedures for conducting year-end closing procedures, such as making journal entries to accrue liabilities, to reclassify capital outlays, to book debt payments, and to record transfers of funds prior to the commencement of the audit.

TOWN OF CLAYTON

SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONT'D)

STATUS OF PRIOR YEAR FINDINGS

Status: During our current year audit, we noted that the Town had not implemented procedures for conducting year-end closing procedures.

Corrective Action Plan: The procedures will be written out to be followed for next year's audit.

09-02 CUSTODIAL CREDIT RISK

Condition: The Town does not have a policy regarding custodial credit risk.

Criteria: Custodial credit risk is the risk that, in the event of a bank failure, the Town's deposits may not be returned. Accounts at these financial institutions are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000. The Town has not experienced any losses related to these accounts and believes it is not exposed to any significant credit risk.

Cause: No policy approved and implemented to identify custodial credit risk and limitations regarding the total amount of funds held in one financial institution.

Effect: Deposits in excess of the FDIC limits are exposed to credit risk.

Status: During our current year audit, we noted that the Town had obtained collateral pledged from their financial institution to eliminate credit risk relating to deposits that exceed current FDIC limits.

10-01 INVENTORY RECORDS

Condition: The Town does not maintain a record of inventory on hand.

Criteria: The Town should be maintaining a list of inventory on hand at any given time period.

Cause: No policy had been implemented to maintain, track, and record inventory on hand that is used by the Department of Public Works.

Effect: Without an effective inventory schedule the Town has no idea of what inventory is on hand.

Recommendation: We recommend that the Town establish a schedule of inventory which shows the inflows and outflows of inventory items.

Corrective Action Plan: The Town currently has implemented an inventory schedule that allows them to track items currently in inventory.